

ORIGINAL

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

DOCKET FILE COPY ORIGINAL

FEB 7 1997

RECEIVED
OFFICE OF GENERAL COUNSEL

In the Matter of

International Settlement Rates

)
)
) File No. IB 96-261

COMMENTS OF AT&T CORP.

Mark C. Rosenblum
Elaine R. McHale
James J. R. Talbot

295 N. Maple Avenue
Room 3252H3
Basking Ridge, NJ 07920
(908) 221-8023

Gene C. Schaerr
Daniel Meron
1722 Eye Street, N.W.
Washington, D.C. 20006

Dated: February 7, 1997

No. of Copies rec'd
Lit. ABODE

045

Table of Contents

SUMMARY	i
INTRODUCTION.....	1
I. THE PUBLIC INTEREST REQUIRES ACTIVE ENFORCEMENT OF UPDATED BENCHMARKS	4
1. Compliance with the 1992 Benchmarks Has Been Inadequate	5
2. Termination Costs for International Services Have Continued to Decrease.....	8
3. Settlement Cost Reductions Benefit U.S. Consumers	9
4. Lower Benchmarks Must be Accompanied by Active Enforcement to Deliver Benefits to Customers.....	12
II. THE NEW BENCHMARK LEVELS SHOULD ENCOURAGE THE RAPID TRANSITION TO COST-BASED RATES	14
1. Country Benchmarks Should be Set at the Lower of the Relevant Benchmark Range or Country-Specific Tariff Component Price	15
2. Benchmarks Should Apply to All Countries	18
3. All Countries Should Transition to the New Benchmarks by January 1, 2000.....	19
III. U.S. CARRIERS' COSTS PROVIDE A REASONABLE SURROGATE FOR FOREIGN CARRIERS' TOTAL SERVICE LONG RUN INCREMENTAL COSTS	21
1. TSLRIC is the Proper Measure of Cost for Settlement Rates	22
2. Foreign Access Charges Should be Competitively Neutral.....	25
3. U.S. Carriers' Average Cost Data Provide a Generous Surrogate for Foreign Carriers' TSLRIC Data	27
IV. THE COMMISSION SHOULD ESTABLISH BENCHMARK ENFORCEMENT PROCEDURES AND ACT PURSUANT TO CARRIER COMPLAINT	31

1.	The Only "Safe Harbor" Should be the Adoption of Benchmark Rates, or of Interim Proportionate Steps Towards These Rates During the Transition Period	32
2.	Carrier Complaint Should be the Primary Impetus for Enforcement	32
V.	SETTLEMENT RATES SHOULD BE SET AT TSLRIC PRIOR TO AUTHORIZATION OF INBOUND SWITCHED SERVICES OVER INTERNATIONAL PRIVATE LINES.....	34
1.	Requiring Settlement Rates To Be Within The Benchmark Range Would Not Remove The Incentive For One-Way By-pass	35
2.	Regulatory Monitoring would Not Provide Adequate Protection....	37
VI.	SETTLEMENT RATES SHOULD BE SET AT TSLRIC TO PREVENT COMPETITIVE DISTORTION WHEN FOREIGN CARRIERS PROVIDE U.S.-OUTBOUND FACILITIES-BASED AND SWITCHED RESALE SERVICES TO AFFILIATED MARKETS	39
1.	Foreign Carriers Have Strong Incentives to Enter the U.S. International Services Market and to Engage in Anticompetitive Conduct.....	41
2.	The Burdens of Attempting to Address Competitive Distortion Through Regulation Require Continued Use of the ECO Test Unless Entry is Conditioned on Cost-Based Rates.....	43
VII.	THE COMMISSION HAS THE AUTHORITY TO MANDATE SETTLEMENT RATES.....	46
1.	The Commission Has Ample Authority To Regulate Rates and Practices With Respect To International Telecommunications Services	46
2.	The Authority Is Not Diminished By The Fact That U.S. Carrier Settlement Practices Are Memorialized in Inter-Carrier Contracts ..	48
3.	This Authority Is Not Diminished By The Fact That One Of The Parties To The Contract Is A Foreign Carrier	52
	CONCLUSION	59

SUMMARY

AT&T welcomes the Commission's initiative to revise its benchmark settlement rates. As the NPRM emphasizes, above-cost settlement rates raise consumer prices, distort market performance and restrict market growth. Above-cost settlement rates also provide foreign carriers with an unfair annual subsidy from U.S. consumers and carriers that is now approaching \$4 billion. While there have been modest reductions in settlement costs -- fully reflected in prices to U.S. consumers -- since the Commission established its existing benchmarks in 1992, settlement rates have not come down as the Commission expected. In every country, including the most liberalized, settlement rates remain above cost, frequently by factors of five or ten, or even more. Contrary to the Commission's expectations in 1992, and although technology costs have continued to fall, the number of countries willing to bring their rates within the existing benchmarks has been disappointingly few. New Commission action to reduce settlement rates is therefore essential.

The NPRM correctly selects total service long run incremental cost as the proper measure of cost for settlement rates, as this is the level that would prevail in fully competitive markets. The overriding purpose of new benchmark rates should be to encourage countries quickly to move their rates down to this even lower, cost-based level. To promote this critical objective, all countries should be required to set their rates at the lower of either the relevant benchmark range or the country-specific tariff-component price by the end of the transition period. Combining the two alternative methods proposed by the Commission for setting benchmarks in this way would both encourage lower benchmark rates and prevent foreign carriers from charging U.S. carriers more than

they charge their domestic consumers. AT&T further proposes that the proposed transition periods should be reduced in length, and that the Commission's benchmark and transition requirements should apply to all countries, irrespective of their level of economic development or acceptance of telecommunications liberalization.

Until the total service long run incremental cost of terminating U.S. international services in each country is determined, the Commission will require a proxy to establish the bottom of the benchmark ranges and to set entry conditions to prevent competitive distortion. U.S. carrier average cost data provide a generous surrogate for this purpose and should be used pending the development of a suitable forward-looking economic cost model or the submission of satisfactory data by foreign carriers.

A key component of the Commission's future approach to settlement rate benchmarks must be active enforcement. The experience of the past four years demonstrates that compliance will not be sufficient if benchmarks are merely negotiation targets. Whatever mechanism is used to establish the new benchmarks, and whatever the transition periods, the active use of the Commission's enforcement powers will be necessary to bring rates to these levels. AT&T fully agrees with the Commission's long-standing conclusion that it has the authority to prescribe the settlement rates that U.S. carriers pay to their foreign correspondents. Accordingly, Commission enforcement action should be taken when U.S. carriers notify the Commission that transition or benchmark settlement rate requirements have not been met. This rulemaking should establish that the Commission will prescribe settlement rates under expedited procedures in such circumstances.

Finally, AT&T supports the NPRM's initiative to use settlement rates to prevent competitive distortion from foreign carriers' provision of switched services over international private lines or of facilities-based IMTS. However, the settlements process can provide an effective substitute for the Commission's existing equivalency and effective competitive opportunities tests only if the required settlement rates remove all incentive to cause competitive harm in the U.S. market. That requires settlement rates to be set at total service long run incremental cost on routes on which switched services are provided over international private lines, or where foreign carriers provide U.S. outbound switched services to affiliated markets. The NPRM's proposed reliance upon regulatory monitoring to identify competitive harm would be both ineffective and unduly burdensome. Thus, if the Commission accepts the NPRM's proposal to require benchmark settlement rates for this purpose, rather than the cost-based rates that AT&T recommends, the Commission should also continue its present use of the equivalency and effective competitive opportunities tests.

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

In the Matter of)	
)	
International Settlement Rates)	File No. IB 96-261

COMMENTS OF AT&T CORP.

AT&T Corp. ("AT&T") hereby submits its Comments in response to the Notice of Proposed Rulemaking¹ concerning the Commission's proposed revision of its benchmark settlement rates for international switched telephone service between the U.S. and other countries.

INTRODUCTION

The Commission's proposal to set new benchmark settlement rates is a critical initiative that AT&T wholeheartedly supports. As shown in Section I below, above-cost settlement rates cause high prices for U.S. and foreign consumers, restrict market growth, and provide a growing annual U.S. subsidy to foreign carriers of almost \$4 billion. Above-cost settlements also provide foreign carriers with the ability to cause competitive harm to U.S. carriers and consumers through the one-way by-pass of U.S.-inbound settlements or by providing U.S.-outbound switched services to their home

¹ *International Settlement Rates*, IB Docket No. 96-261, Notice of Proposed Rulemaking, (released Dec. 19, 1996), FCC 96-484 ("NPRM").

markets. "[T]hrough high, above cost settlements payments that increase the profitability of foreign monopolists," the Commission has observed, "the U.S. may be 'exporting' the benefits of competition."² AT&T emphatically agrees, and urges the Commission to set and enforce new benchmarks as follows:

- As shown in Section II below, carriers from all countries should set settlement rates at the lower of either the relevant benchmark range or the country-specific tariff-component price by the end of the transition period.
- The new benchmarks should become effective by June 1, 1998 for carriers from upper income countries, by January 1, 1999 for carriers from middle income countries, and by January 1, 2000 for carriers from low income countries. As a general matter, there should be no exceptions to these periods.
- All foreign carriers should begin an immediate transition towards their new benchmark rates within 30 days of the Commission's Order and should reduce their existing settlement rates toward their new level by equal proportionate annual amounts.
- The proper level for settlement rates is the foreign carrier's total service long run incremental cost, as AT&T demonstrates in Section III, and this should constitute the bottom of each country's benchmark range. Until this cost is determined for each country or carrier, or a cost-proxy model is developed to estimate these costs, U.S. carrier average cost data provides a generous surrogate. However, foreign carriers

² *Motion of AT&T to be Declared Non-Dominant for International Service*, FCC 96-209, Order, (released May 14, 1996) ("*AT&T Non-Dominance Order*"), at ¶ 85.

should be entitled to demonstrate that their total long run incremental termination costs are higher than this level.

- Where the relevant foreign carrier has not adopted the required benchmark rate or the necessary interim steps toward that rate during the transition period, the Commission should exercise its prescriptive powers, as shown in Section IV. The Commission should require U.S. carriers to pay at the low end of the benchmark range or, if the complaint concerns the failure to meet transition steps, to pay at the benchmark rate. The prescription process should commence upon carrier complaint and conclude in an expedited timeframe.
- The Commission should require accounting rates to be at the bottom of the benchmark range (i.e., at total service long run incremental cost, or a surrogate rate) before authorizing the relevant foreign carrier to enter the U.S. market to provide switched facilities-based services, or before authorizing switched services to be provided over international private lines between the U.S. and the relevant country, as AT&T demonstrates in Sections V and VI. Unless settlement rates are set at cost for these purposes, the Commission should continue to require adherence to the effective competitive opportunities and equivalency tests.

As shown in Section VII, all of these actions would be well within the Commission's authority under the Communications Act, relevant case law and international regulations.

Adoption of these steps would result in significant consumer benefits. As should be expected in the competitive U.S. market, savings in settlement costs are passed

on to consumers. If the Commission's enforcement of new benchmarks leads to further savings in settlement costs, competition will continue to ensure that these savings are reflected in lower U.S. carrier prices.

I. THE PUBLIC INTEREST REQUIRES ACTIVE ENFORCEMENT OF UPDATED BENCHMARKS

AT&T fully supports the NPRM's conclusion that the Commission's existing settlement rate benchmarks are "obsolete" (§ 3) and should be replaced. The Commission established the existing benchmarks over four years ago to reduce a U.S. settlements deficit that was then almost \$3 billion and a foreign carrier subsidy then estimated at \$1 billion.³ Since 1992, reductions in settlement rates have fallen far short of the Commission's expectation at that time that most countries would reduce rates by 50 percent within two years (*i.e.*, by 1994).⁴ After more than four years, despite continued reductions in termination costs, the overwhelming majority of countries are still far from this goal and the annual U.S. settlements deficit is now over \$5 billion. The NPRM (§ 8) properly notes that "at least three-quarters" of this deficit is a subsidy from U.S. consumers and carriers to foreign carriers.

Because there is no reasonable prospect that the existing pace of reductions in settlement rates can arrest this mushrooming subsidy, the Commission should not only

³ *Regulation of International Accounting Rates*, 6 FCC Rcd. 3434, 3435 (1991)(Further Notice of Proposed Rulemaking)("Phase II Further Notice"). See also, *Regulation of International Accounting Rates*, 7 FCC Rcd. 8040 (1992) ("Second Report and Order and Second Further Notice of Proposed Rulemaking" ("Second Report and Order")).

⁴ *Id.* at 8043.

adopt new benchmarks that more closely reflect settlement costs, but should also mandate compliance by U.S. carriers. Unless the Commission enforces the new benchmarks, they will have no greater impact on settlement rates than existing benchmarks, and the rapid growth of the U.S. subsidy to foreign carriers will continue. As demonstrated below, the competitive U.S. market ensures that reductions in settlements costs lead to reductions in industry prices. Strong Commission enforcement of new benchmarks will benefit the public interest through lower prices for consumers, greater efficiencies for U.S. carriers and an improved U.S. balance of payments.

1. **Compliance With The 1992 Benchmarks Has Been Inadequate.**

In 1992, the Commission adopted benchmark settlement rates of \$0.23-\$0.39 per minute for Europe and \$0.39-\$0.60 for the rest of the world.⁵ These were the Commission's "conservative" estimates of appropriate ranges based on the underlying costs to terminate international calls.⁶ The Commission anticipated that the use of these benchmarks as targets in accounting rate negotiations, coupled with efforts by foreign carriers to reduce their accounting rates toward cost in accordance with Recommendation D.140 of the International Telegraph and Telephone Consultative Committee ("CCITT"),⁷ would reduce accounting rates by 50 percent within one to five years. However, the Commission also expected "most countries to reach this goal within two years."

⁵ *Second Report and Order* at 8041.

⁶ *Id.*

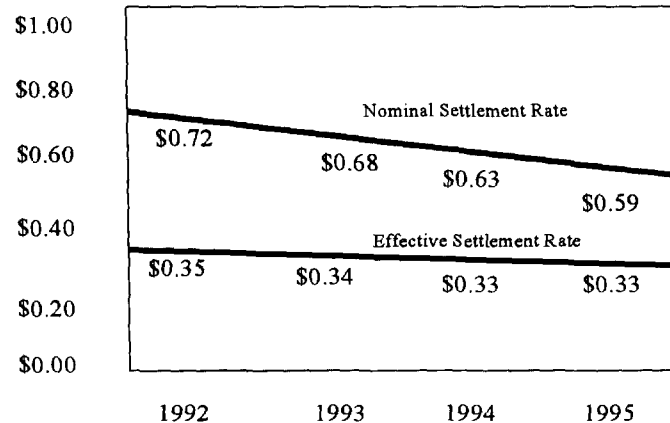
⁷ *Id.* at 8043.

Despite the efforts of the Commission and U.S. carriers, settlement rates have not been reduced to the degree anticipated in 1992. As shown by Chart A below, instead of the 50 percent reduction expected by the Commission, the nominal settlement rate on a worldwide average paid by U.S. carriers declined from \$0.72 to \$0.59 between 1992 and 1995, the last year for which such information is available -- a reduction of only 18 percent.⁸ As Chart A also shows,⁹ the effective settlement rate paid by U.S. carriers decreased over the same four year period from \$0.35 to \$0.33, a reduction of only 6 percent.¹⁰

⁸ The nominal settlement rate is calculated by dividing the total U.S. net settlement outpayment by total imbalanced U.S. billed minutes. However, the NPRM (§ 26 & n.34) appears to have calculated a nominal settlement rate based on all U.S. billed minutes, rather than the imbalance. Because the settlements process is a "netting" process, whereby payments are made on the imbalance of calls delivered, the nominal settlement rate is paid only on the imbalance and should be calculated accordingly.

⁹ The data used in this chart includes Canada and Mexico traffic. Prior to 1991, FCC data excluded these countries, and AT&T's submissions in earlier phases of this proceeding were based on traffic volumes excluding Canada and Mexico.

¹⁰ The effective settlement rate converts the nominal settlement rate applicable to imbalanced minutes to a per minute cost for all U.S. outbound minutes. It is calculated by dividing the total U.S. industry net settlement outpayment by total U.S.-billed minutes.

Chart A**Industry Nominal Settlement Rate and Effective Settlement Rate****US - World**

Source: FCC 43.61 Report Data 1992-1994

FCC 43.61 Report Data 1995 (Preliminary)

Most individual countries' settlement rates have not shown any significant progress toward achievement of the Commission's 1992 goals. As shown in Attachment A, outside Europe, only three countries have reduced their 1992 settlement rates by as much as 50 percent. Within Europe, twenty-five countries have failed to achieve this goal.

As the NPRM (§ 58) observes, the majority of countries have not reduced their settlement rates to the Commission's 1992 benchmark ranges. Attachment A shows that settlement rates in thirty European countries are still above the 23-39 cent range, while outside Europe, rates in 92 countries are still above the 39-60 cent range. These non-complying countries include 40 out of 49 countries in Asia, 39 out of 55 countries in Africa, and eight out of twelve countries in South America.

Moreover, any positive effect on the U.S. settlements deficit from the modest decreases in settlement rates obtained since 1992 is far outweighed by the

increased outpayments caused by the growing imbalance of U.S.-outbound over U.S.-inbound traffic. As shown in Attachment B, the imbalance of U.S.-outbound over U.S.-inbound traffic has grown by about 75 percent since 1992. As a result, the subsidy paid by U.S. consumers and carriers to foreign carriers through settlements outpayments has continued to increase.¹¹

2. **Termination Costs for International Services Have Continued to Decrease.**

In the proceeding that established the 1992 benchmarks, the Commission noted the "dramatic" technology improvements in telecommunications facilities, particularly in undersea cables, and the downward trend in the costs of providing international services.¹² The CCITT recognized the same trend that year in adopting Recommendation D.140.¹³ Technological advances since 1992 have continued to reduce

¹¹ The traffic imbalance has grown steadily since the early 1980's, as the lower U.S. rates brought by competition have generated greater outbound calling volumes than the inbound volumes resulting from higher foreign prices. Much more recently, the imbalance has been further stimulated by the advent of switched services provided over international private lines and, as the NPRM (§ 12) observes by call-back, which allows foreign customers to originate U.S.-outbound calls in order to take advantage of lower U.S. prices. Some foreign carriers suggest that this traffic imbalance is wholly attributable to call-back and to U.S. carriers' use of the country direct services they have provided to serve travelling U.S. customers -- ignoring that it is above-cost accounting rates that drives arbitrage by carriers and leads customers to seek to avoid the high foreign prices that follow high accounting rates. Even if all settlement rates were priced at economic cost, a U.S. outpayment would continue to exist as long as U.S.-outbound traffic exceeded U.S.-inbound traffic. But if settlement rates were cost-based, the outpayment would be a sign of economic growth as it would include no subsidy payment to foreign carriers.

¹² See *Regulation of International Accounting Rates*, 6 FCC Rcd. 3552, 3555-56 & n.53 (1991)(Report and Order).

¹³ See Recommendation D.140, at §(h) (acknowledging that "some accounting rates have not kept pace with the recent cost trends and are therefore too high").

the costs of international transmission, as the NPRM (§ 27) observes. The original capital costs of the TAT-12 and TAT-13 undersea cables brought into service in 1995 and 1996, for example, are one third the capital cost of the TAT-11 cable brought into service in 1993.¹⁴ As a result, international service termination costs are now even further below the conservative estimates used by the Commission in establishing benchmarks in 1992.

3. Settlement Cost Reductions Benefit U.S. Consumers.

Nonetheless, the modest reductions in settlement rates since 1992 have resulted in lower costs for U.S. carriers and lower prices for U.S. consumers. The key measure of settlement cost for this purpose is the effective settlement rate, which reflects the per minute cost of providing switched services.¹⁵ Importantly, because settlements are paid only on imbalanced minutes, not on every outbound minute, the settlement costs of U.S. carriers are determined by the outbound-inbound traffic ratio, in addition to the settlement rate.¹⁶ Consequently, even when the settlement rate payable on each

¹⁴ The original capital cost cost per 64 Kbit half-channel of TAT-12 and TAT-13 was approximately \$6,300 and was expected to decrease to \$3100 with the utilization of unassigned capacity, which is now occurring. *See American Tel. & Tel. Co., et al*, 8 FCC Rcd. 4810, 4813 (1993) (Section 214 authorization). The original capital cost for the same half-channel on TAT -11 was \$9,600. *Id.*

¹⁵ *See supra* n.10.

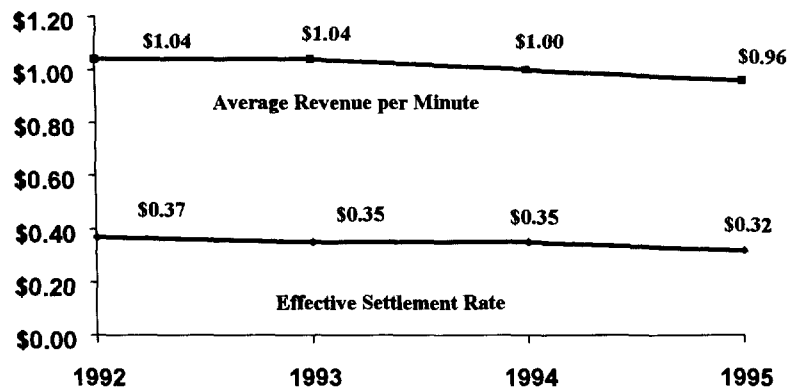
¹⁶ For example, under the 1992 industry traffic ratio of outbound to inbound minutes of 1.93:1, U.S. carriers paid settlements on 93 minutes of every 193 minutes they billed, or on 48 percent of their outbound traffic. But under the 1995 outbound-inbound ratio of 2.23:1, U.S. carriers paid settlements on 123 of every 223 minutes billed, or on 55 percent of their outbound traffic, although at a lower nominal settlement rate.

imbalanced minute declines, settlement costs may still increase if the outbound-inbound ratio changes and the number of imbalanced minutes increases.

Because of the continued growth in the imbalance of U.S. traffic, the reductions in nominal settlement rates obtained since 1992 have not brought commensurate reductions in settlement costs. As already shown in Chart A, despite an 18 percent reduction between 1992 and 1995 in the worldwide average nominal settlement rate paid by U.S. carriers, U.S. carriers' effective settlement rate declined by only 6 percent in that period. However, as demonstrated in Chart B below, reductions in settlement costs were fully reflected in prices to consumers. AT&T's effective settlement rate declined from \$0.37 in 1992 to \$0.32 in 1995, or by \$0.05 per minute. Yet AT&T's average revenue per minute declined from \$1.04 in 1992 to \$0.96 in 1995, or by \$0.08, a greater decrease than the reduction in settlement costs shown by the effective settlement rate.¹⁷

¹⁷ Settlement costs are not the only cost component of international calls and lower settlement costs do not bring the same percentage reduction in the prices of international calls, just as a 10 percent reduction in the cost of steel would not yield a 10 percent reduction in the price of an automobile. The relevant inquiry is rather whether cost savings are reflected in prices on a per-unit, dollar-for-dollar basis. Chart B demonstrates that AT&T's settlements cost savings have been reflected in its prices.

Chart B
AT&T Average Price vs. Average Settlement Cost
 US - World



Source: FCC 43.61 Report Data

This data demonstrates that, contrary to the NPRM's apparent assumption (§ 91), cost savings from settlements reductions are passed through to consumers. As all U.S. carriers benefit from settlement reductions, the competitive U.S. international marketplace ensures that the resulting cost savings are reflected in industry prices. While every U.S. carrier may not pass on settlement cost savings at the same time or to the same extent, the Commission has found that "residential IMTS customers are very price sensitive, and can be expected to switch international carriers in response to price promotions."¹⁸ Even AT&T, the largest U.S. international carrier, "cannot raise and sustain prices above a competitive level for residential services without risking loss of its customers to its competitors."¹⁹ No U.S. carrier can therefore fail to reflect lower

¹⁸ *AT&T Non-Dominance Order*, at ¶ 83.

¹⁹ *Id.*

settlement costs in its prices, or in commensurate service improvements, without risking that same loss of customers.

4. Lower Benchmarks Must be Accompanied by Active Enforcement.

Although the Commission has on several occasions affirmed its authority to establish accounting rates,²⁰ it has thus far declined to do so.²¹ Instead, the Commission sought in 1992 to encourage the establishment of accounting rates within benchmark ranges by requiring the submission of annual progress reports.²² The Commission declined to take "any unilateral actions, including establishing set rates" until it could "evaluate the January 1993 filings and the effects of CCITT Recommendation D.140."²³

More than four years later, it is now apparent that the Commission greatly over-estimated the willingness of countries to reduce accounting rates to cost over one to

²⁰ See *Regulation of International Accounting Rates*, 5 FCC Rcd. 4948, 4951 (1990)(Notice of Proposed Rulemaking)("We believe the Communications Act provides us with broad authority to regulate international telecommunications services, including accounting rates."); *Phase II Further Notice*, 6 FCC Rcd. at 3436 ("[W]e have the authority under Sections 201(a), 201(b), and 205 of the Communications Act, and relevant case law, to establish maximum rates for an entire service and to require that carriers cease and desist from charging, collecting and receiving, or participating in charges above a maximum rate, even though a portion of that service is rendered outside the United States."). See also, *Second Report and Order*, 7 FCC Rcd. at 8040.

²¹ In 1992, the Commission did not adopt the carrier-initiated complaint process recommended by AT&T that could have resulted in Commission directives terminating service agreements with foreign carriers. See *id.* at 8043, 8047.. See also, *Phase II Further Notice*, 6 FCC Rcd. at 3436 ("[W]e believe it would be premature to propose additional regulatory actions . . . to establish the maximum rate that U.S. carriers may pay to terminate U.S.-originated telephone calls . . .").

²² *Second Report and Order*, 7 FCC Rcd. at 8044 (requiring submission of progress reports in 1993 and 1994).

²³ *Id.* at 8047.

five years in accordance with Recommendation D.140. In the face of such continued intransigence, any new benchmarks that function merely as negotiation targets will bring only limited reductions in settlement rates. As the International Settlements Policy recognizes, no U.S. carrier can negotiate accounting rates on a level playing field when the foreign carrier has bottleneck control over the foreign end of the route, which remains the situation in the overwhelming majority of countries.²⁴ Thus, it is hardly surprising that, despite countless hours of hard negotiating by U.S. carriers, most countries have successfully resisted compliance with the 1992 benchmarks. The task faced by U.S. carriers is no easier in many multi-carrier markets, where carriers set accounting rates in lock-step with each other.²⁵ Even in the more liberalized markets, no carrier has yet been willing to reduce its settlement rate to a cost-based level.²⁶

²⁴ See *Mackay Radio & Telegraph Co.*, 2 FCC 592, 599 (1936) ("[t]o expect the [foreign] telegraph administration to play the competing [U.S.] companies against each other is simply to expect that the [foreign] administration will be headed by good businessmen, loyal to their national interests"); *aff'd by the Commission en banc*, 4 FCC 150 (1937); *aff'd sub nom Mackay Radio & Telegraph Co. v. FCC*, 97 F. 2D 641 (D.C. Cir. 1938). See also *Implementation and Scope of Uniform Settlements Policy for Parallel International Communications Routes*, 51 Fed. Reg. 4738 (Feb. 7, 1986) (Report and Order), *Order on Reconsideration*, 2 FCC Rcd. 1118 (1987), *Further Reconsideration*, 3 FCC Rcd. 1614 (1988).

²⁵ Attachment C lists accounting rates between the U.S. and the following eleven multi-carrier markets: Canada, Chile, the Dominican Republic, Finland, Indonesia, Japan, Korea, Mexico, the Philippines, Sweden and Zaire. In each of these countries, all facilities-based carriers maintain identical or near-identical accounting rates.

²⁶ BT, the dominant carrier in one of the more open foreign markets, failed to comply with the Commission's January 1995 directive to file a plan "setting forth further significant reductions by BT toward cost-based accounting rates over the next two years." *BT North America Inc.*, 10 FCC Rcd. 3204, 3205 (1995). BT rather took the position that it would reduce accounting rates on its own schedule and based on whether U.S. traffic volumes were sufficient to provide adequate compensation. See Letter dated March 14, 1995, to William F. Caton, Acting Secretary, Federal

In sum, the experience of the past four years teaches that merely setting new benchmarks will do little to reduce settlement rates in most countries unless the Commission is prepared to use its prescription authority.

II. THE NEW BENCHMARK LEVELS SHOULD ENCOURAGE THE RAPID TRANSITION TO COST-BASED RATES.

The Commission's overriding objective in setting new benchmarks and transition periods should be to move settlement rates for all countries toward cost as rapidly as possible. No country's settlement rate is presently at this level, and some countries' rates are more than twenty or thirty times this amount, as the NPRM (n.43) observes. To promote this key objective, all countries' settlement rates should be required to be at the lower of either the top of the relevant benchmark range or the country-specific tariff-component price by the end of the transition periods. These requirements should apply to all countries, irrespective of their level of economic development or acceptance of liberalization.

The new benchmarks should become effective by June 1, 1998 for carriers in upper income countries, by January 1, 1999 for carriers in middle income countries, and by January 1, 2000 for carriers in lower income countries. Pending those dates, there should be transition periods under which settlement rates for all countries should be

(footnote continued from previous page)

Communications Commission from James E. Graf II, BT. BT's \$0.11 per minute settlement rate remains five times higher than BT's domestic interconnection charge and approximately twice AT&T's estimate of BT's economic cost for the termination of U.S. traffic.

reduced down toward their new benchmark levels by proportionate annual amounts. As described in Section VI below, in response to complaints by U.S. carriers, the Commission should exercise its authority to prescribe the rates that should be paid by U.S. carriers if their foreign correspondents' settlement rate reductions fail to meet these requirements.

1. Country Benchmarks Should be Set at the Lower of the Relevant Benchmark Range or Country-Specific Tariff Component Price.

The NPRM (§ 39) presents two primary options for establishing the upper end of a new benchmark range for each country: using the country-specific tariff component price calculated by the International Bureau,²⁷ or using the average of the tariff component prices of all countries in the same category.²⁸ Although the NPRM (§ 40) is correct that use of the country-specific tariff-component price would ensure that U.S. carriers were treated the same as foreign consumers in their home market, this approach would favor countries with high domestic rates, and would also allow many countries with the most inefficient pricing structures to make the least movement toward cost.²⁹ Indeed,

²⁷ *Foreign Tariffed Component Prices*, International Bureau, Federal Communications Commission, Dec. 1996 ("*International Bureau Study*").

²⁸ In both cases, the foreign carrier's termination cost would constitute the bottom of the range.

²⁹ Both the NPRM (§ 40) and the *International Bureau Study* (p. 5) emphasize that the proposed tariff-component prices are far in excess of cost. A primary reason is that the tariff-component prices are compiled by using foreign carrier tariffs (and their attendant profit margins) for two of the three components of international termination services -- international transmission, and domestic distribution and termination. The *International Bureau Study* (pp. 4-5) notes that foreign carriers' domestic tariffs for domestic distribution and termination are above international termination costs because they include retail expenses and overhead and "generally reflect monopoly rents." The same deficiencies apply to foreign carriers' tariffs for dedicated international private line service, which the *International Bureau Study* (pp. 7-9) uses to estimate the price of international transmission. Even the international switching

as the NPRM (§ 46) acknowledges, by setting settlement rates at tariff-component prices, countries may be encouraged to raise their domestic rates in order to increase settlement payments.

The NPRM (§§ 39, 43, 45-47) contends that deficiencies resulting from reliance on tariff-component prices are sufficiently mitigated by: (1) classifying countries in categories based on levels of economic development; and (2) using the average of the tariff component prices in each category to establish the upper end of each benchmark range. Such an approach has the advantage of averaging the most inefficient foreign carrier tariffs with those that are more efficient.³⁰ Additionally, by classifying countries into different categories based on levels of economic development, rather than adopting a single average for all countries, the Commission would encourage greater movement toward cost by higher income countries, while reducing the burden of compliance for less developed countries.

(footnote continued from previous page)

facility component of these tariff-component prices does not reflect economic cost. *The International Bureau Study* relies (pp. 9-12) for this component upon ITU-published information that, as shown above, reflects embedded costs rather than total service long run incremental costs as it is not limited to the most efficient available technology.

³⁰ The upper limit of the benchmark ranges should be set through a simple average of the tariffed component prices of the countries in each category, rather than by employing any of the standard deviations referenced in the NPRM (§§ 48-49). The choice of any particular measure of deviation would indeed have no "particular relevance" (NPRM § 49) to the appropriateness of benchmark ranges. Moreover, the use of any such measure would raise the upper end of the benchmark ranges and thus encourage countries to make much slower progress toward cost.

However, the Commission would obtain even greater advantages for U.S. consumers and carriers by combining both suggested approaches. AT&T recommends that the upper end of each country's benchmark range be set at the lower of either that country's tariff component price or the benchmark range for the relevant category of countries. Otherwise, if the upper end of the range is based on an average tariff-component price, many countries with tariff-component prices below the average will continue to discriminate against U.S. carriers.³¹ Even if a country is within the benchmark range, there is still "no justifiable economic basis for requiring a U.S. carrier to pay a foreign carrier more than that carrier charges its domestic customers for the same service." (NPRM ¶ 40). Prohibiting carriers from charging settlement rates in excess of their country-specific tariff component prices, in addition to requiring them to bring their settlement rates within the proposed benchmark ranges, would also best serve the key public interest objective of encouraging foreign carriers from all countries to make the greatest movement toward cost as rapidly as possible.

³¹ For example, the tariff component prices of various upper income countries are under 10 cents, including Hong Kong (\$0.07), Israel (\$0.085), Kuwait (\$0.09) and Singapore (\$0.08). Under the proposed benchmark ranges, these countries would only be required to reduce their settlement rates to \$0.154. Almost as low are the tariff component prices of some middle income countries, including Costa Rica (\$0.10), Ecuador (\$0.10), Guatemala (\$0.10) and Jamaica (\$0.09), and even two low income countries, Guyana (\$0.12) and Nicaragua (\$0.12). Yet the proposed ranges would only require settlement rates of \$0.191 for middle income countries and rates of \$0.234 for low income countries.

2. Benchmarks Should Apply to All Countries.

Contrary to the proposal of the NPRM (§ 69), there should be no exception to the benchmarks for carriers from countries that adopt or commit to competitive reform, even in the case of a developing country. The NPRM (§ 69) would justify such forbearance on the grounds that in competitive markets international call termination rates will soon fall below benchmark rates. But elsewhere, the NPRM states more cautiously that "[e]ffective competition . . . would ultimately drive international termination charges closer to costs." (§ 20 (emphasis added)). This long-term consequence offers little relief to U.S. consumers -- even if liberalization abroad would inevitably lead to cost-based rates. And as no country, even where competition is fully accepted, has yet adopted a cost-based settlement rate, AT&T believes that caution in such predictions is to be preferred. In particular, there is no basis for any conclusion that developing countries that are merely "committed" to liberalization will quickly bring rates within benchmarks. The example of Chile, a liberalized country where the 1996 settlement rate of \$0.45 is more than twice the proposed upper limit of the relevant country category, would rather suggest otherwise. In any event, to the extent that the NPRM's optimism is proven correct, benchmarks will quickly become irrelevant to these countries. No exercise of forbearance is therefore necessary here.

The Commission should also decline to award "additional flexibility" (NPRM § 72) to carriers from developing countries on the basis of any low level of network development. The proposed benchmarks already take account of developing countries by providing middle and low income countries with higher benchmark ranges

and longer transition periods. The potentially broad flexibility suggested here would, in effect, sanction the continued use of settlement payments to these countries for subsidy purposes. These countries' network needs should rather be met by competitive markets and private capital which, as the NPRM (§ 60) observes, are far more effective in financing infrastructure development than the accounting rate system.

3. All Countries Should Transition to the New Benchmarks by January 1, 2000.

Given the general failure of foreign carriers to move to the 1992 benchmark levels, the Commission would best promote the critical public interest objective of moving all countries' settlement rates to cost as quickly as possible by reducing the lengthy transition periods suggested by the NPRM.³² AT&T proposes that rates for carriers in upper income countries should be required to comply with the new benchmarks by June 1, 1998, rates for carriers in middle income countries by January 1, 1999, and rates for carriers in lower income countries by January 1, 2000. These shorter transition periods would provide adequate time for U.S. carriers to negotiate settlement rates in compliance with benchmark levels while avoiding any undue disruption of operations. Since the issuance of the first NPRM in 1990, all foreign carriers have been on notice that today's massive U.S. settlements subsidy payments are not destined to continue. That notice was further confirmed four years ago by CCITT Recommendation D.140 and the issuance of the Commission's 1992 benchmarks. Accordingly, with the

³² The NPRM (§ 63) proposes transition periods of one year for upper income countries, two years for middle income countries and four years for lower income countries.